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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1957.

No. 306.

THE COLONY, INC., Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR THE PETITIONER.

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Where petitioner fully reported all of its gross receipts in its tax returns, but the Tax Court determined there had been an erroneous overstatement of cost of property sold, resulting in an error in the computation of gross income, such overstatement does not constitute an omission from gross income of any amount properly includible therein within the meaning of Section 275(c) of the Internal Revenue Code of 1939	10
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BRIEF FOR THE PETITIONER.

OPINIONS BELOW.

The opinion of the Court of Appeals is printed in the Record (R. 42). It is reported at 244 F. 2d 75. The opinion of the Tax Court of the United States is printed in the Record (R. 1). It is reported at 26 T. C. 30.

JURISDICTION.

The judgment of the Court of Appeals was entered on April 22, 1957 (R. 42). The petition for a writ of certiorari was filed on July 22, 1957, and was granted on October 14, 1957 (R. 43). The jurisdiction of this Court is invoked under 28 U. S. C. Sec. 1254 (1).

QUESTION PRESENTED.

The single important question presented by this case may be stated in two different ways:

1. Where petitioner reported all of its gross receipts on its federal income tax returns, is the five year statute of limitations provided by Section 275(c) of the Internal Revenue Code of 1939 nevertheless applicable because of an erroneous overstatement of the cost basis of the property sold in an amount in excess of 25% of the gross income computed and stated in the returns?

2. Does the language "omits from gross income an amount properly includible therein", as stated in Section 275(c) of the 1939 Code, mean (a) "leaves out an item or items of receipt from his computation of gross income", or (b) "understates the final figure in his gross income computation"?

STATUTE INVOLVED.

The full text of Section 275(c) of the Internal Revenue Code of 1939 (26 U. S. C. 1946 ed., Sec. 275(c)) is as follows:

"Sec. 275—Period of Limitation Upon Assessment and Collection.

* * * * * * *

"(c) *Omission From Gross Income.*—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25%

of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed."

STATEMENT OF THE CASE.

The material facts are not in dispute. As found by the Tax Court (R. 3, 7-15), and contained in the Record, they may be summarized as follows:

Petitioner is a corporation organized under the laws of the Commonwealth of Kentucky on or about November 14, 1945 (R. 3). Petitioner kept its books and filed its federal tax returns on an accrual method for fiscal years ended October 31 (R. 3). Petitioner filed federal income tax returns for its taxable years ended October 31, 1946 and October 31, 1947 with the Collector of Internal Revenue for the district of Kentucky (R. 3).

Shortly after its organization, petitioner acquired a farm near Lexington, Kentucky (R. 7). Petitioner's principal business during 1946 and 1947 consisted of the subdivision and development of the farm land into residential lots, and the sale of such lots to individual buyers (R. 7, 8).

In its federal income tax returns for its taxable years ended October 31, 1946 and 1947, petitioner reported *all* of the gross receipts realized from the sale of lots during said years (Resp. Ex. D, Sch. A; R. 32 and Resp. Ex. E, Sch. A; R. 38). In said tax returns, petitioner subtracted the reported cost of the lots sold from the gross sales proceeds to compute the gross

profit on lot sales (Resp. Ex. D, Sch. A; R. 32 and Resp. Ex. E, Sch. A; R. 38). The resulting gross profit was then combined with petitioner's other income, and the total carried forward and shown on page 1 of each tax return at line 15, labeled "Total income" (Resp. Ex. D; R. 27 and Resp. Ex. E; R. 36).

Petitioner's reported cost basis of the lots sold included a proportionate part of the estimated cost of developing the subdivision (R. 8). A principal item included therein was the expense of constructing a water supply system (R. 8).

Upon examination of petitioner's federal income tax returns for its taxable years 1946 to 1950, inclusive, respondent disallowed apprpximately one-half of the total estimated development costs, including the cost of the water supply system (R. 8). As a result of his determination, respondent reduced the cost of the lots sold as claimed in the tax returns for the taxable years 1946 and 1947, thereby increasing petitioner's gross profit from the sale of lots, and "Total income" (or "gross income"[1]) for said years by the same amount.

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[1]There is no single item or line on the corporate income tax return (Treasury Form 1120) labeled "gross income". However, the heading to the first 15 lines of the return is "Gross Income", and line 15 is labeled "Total income". The figure to be inserted on line 15 is reached as a result of computation—*e. g.*, gross receipts, less cost of goods sold, plus other income is equal to "Total income". Thus, "Total income" on the tax return is synonymous with "gross income of a manufacturing, etc, concern" as defined by Treasury Regulations 111, Sec. 29.22(a)-5.

In this brief, petitioner, solely for purposes of convenience, uses the terms "Total income" and "gross income" interchangeably. Petitioner does not concede that, as a matter of law, "Total income" and "gross income of a manufacturing etc. concern" are synonymous or interchangeable.

Respondent's statutory notice of deficiency for the years ended October 31, 1946 and October 31, 1947 was mailed to the petitioner within an extended period provided in waivers which petitioner executed more than three years but less than five years after the returns for said taxable years were filed (R. 15).

Petitioner duly and timely filed a petition with the Tax Court of the United States. The Tax Court held that the respondent was correct in disallowing certain of the claimed development costs, including the cost of the water supply system, thereby increasing gross income by the same amount (R. 19-25). The Tax Court held that, as a result of the overstatement by petitioner on its tax returns for the years 1946 and 1947 of the cost of the lots sold, petitioner "omitted" from gross income an amount properly includible therein which was in excess of 25% of the amount of gross income stated in its returns (R. 15). Accordingly, the Tax Court ruled that the five year period of limitations contained in Section 275(c) of the Internal Revenue Code of 1939 was applicable, and that the assessment of the deficiencies for the years 1946 and 1947 was not barred (R. 25).

Petitioner duly and timely appealed to the Court of Appeals for the Sixth Circuit on the sole question of whether the five year statute of limitations was applicable in respect of the deficiencies determined for the taxable years ended October 31, 1946 and October 31, 1947. The Court of Appeals affirmed the Tax Court, stating in its opinion as follows (R. 42, 43):

". . . it is the petitioner's contention that the general three year limitation period of section 275(a) of the 1939 Code is applicable. As petitioner's counsel correctly points out, the decisions of the Courts of Appeals of several other circuits give clear support to this view. *Uptegrove Lumber Co.* v. *Commissioner,* 204 F. 2d 570 (3 Cir., 1953); *Deakman-Wells Co.* v. *Commissioner,* 213 F. 2d 894 (3 Cir., 1954); *Goodenow* v. *Commissioner,* 238 F. 2d 20 (8 Cir., 1956) cf. *Slaff* v. *Commissioner,* 220 F. 2d 65 (9 Cir., 1955); *Davis* v. *Hightower,* 230 F. 2d 549 (5 Cir., 1956).

"The reasoning of these cases is not without considerable persuasive force, and if the question were here for the first time, we might be disposed to follow them. However, the question has already been decided by this court in *Reis* v. *Commissioner,* 142 F. 2d 900 (6 Cir., 1944), where it was held that the five-year limitation was applicable when the taxpayer's understatement of gross income of more than twenty-five per cent was the result of his overstatement of the cost basis of property sold. The facts in the *Reis* case are, of course, not identical with the facts in the present case, but the issue presented is the same.

"Upon the authority of *Reis* v. *Commissioner* the decision of The Tax Court is affirmed."

SUMMARY OF ARGUMENT.

Section 275(a) of the Internal Revenue Code of 1939 provides that income taxes generally must be assessed by the Commissioner of Internal Revenue within three years after the tax return is filed.[2] Section 275(c), an exception to the general rule, provides that the Commissioner has two additional years (five years after the return is filed) to assess the tax if the taxpayer "omits from gross income" an amount in excess of 25 per centum of the gross income reported in the return.

Section 275(c) is not applicable where a taxpayer (such as petitioner) fully reports all gross receipts in his tax return, but erroneously overstates the cost basis of the property sold, thereby reducing gross profit from sales, and gross income, by the same amount. The statute is applicable only where a taxpayer leaves out items of receipt in the statutory amount from the computation of gross income.

A. The key-word in the statute is the verb "omits". In normal usage, omits means "to leave out or unmentioned; not to insert, include or name".

B. The legislative history shows beyond question that Congress enacted Section 275(c) for the sole purpose of giving the Commissioner a period longer than

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[2] "Sec. 275. *Period of Limitation Upon Assessment and Collection.* (26 U. S. C 1946 ed., Sec. 275)

Except as provided in section 276—

(a) *General Rule*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period."

three years to discover income in the case of taxpayers who failed to fully report their receipts. The relevant Congressional Committee reports and discussions at committee hearings point specifically and only to the taxpayer, who, to use the Committees' words, "failed to disclose", who was "so negligent as to leave out items of such magnitude", who "left out", who "was so negligent and so forgetful, or whatever the reason is, that he overlooks an item amounting to as much as 25%", who "failed to report".

C. From a logical standpoint, the statute can be applicable only to situations where a taxpayer left out items of receipts in his computation of gross income.

Overstatements of cost of goods sold are similar in nature to other expenditures expressly deductible by statutory law. Both are *subtrahend* items, and for benefit to be derived therefrom, both must be specifically claimed in the tax return. The Commissioner is immediately put on notice of the items by a mere examination of a tax return, and is given ample opportunity to investigate.

It is clear that the Commissioner must challenge claimed statutory deductions within the normal three year limitation period. It is not logical to assume that Congress would wish to allow a longer time to challenge increased income resulting from overstatements of *subtrahends* in the gross income section of a return.

D. Four Circuit Courts of Appeal have held uniformly in varying factual situations that the verb "omits" as used in Section 275(c) means "leaves out"

some item of receipt from the computation of gross income. Each court has rejected the Commissioner's contention that the statute can be applied where a taxpayer understates the final figure in his gross income computation. The court below stands alone among the federal appellate courts in construing the statute to apply to mathematical understatements of gross income resulting solely from an overstatement of the cost of goods sold.

E. Section 6501 (e)(1)(A) of the Internal Revenue Code of 1954,[3] the successor to Section 275(c), expressly spells out the construction of Section 275(c) urged herein. The old language of Section 275(c) was re-enacted, and the new langugae was added to clarify the law under the 1939 Code.

The statutory language, the legislative history, logical reasoning, the weight of judicial authority in the courts below, and the enactment by Congress of Section 6501(e)(1)(A) of the Internal Revenue Code of 1954 establish that "omits from gross income" as used in Section 275(c) means leaving out items of receipts in the computation of gross income. An *overstatement* of the cost of property sold, resulting in an *error* in the computation of gross income, does not entitle the Commissioner to the benefit of the extended period of limitations provided for by the statute.

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[3]Quoted, note 9, at page 23, *infra*.

ARGUMENT.

Where petitioner fully reported all of its gross receipts in its tax returns, but the Tax Court determined there had been an erroneous overstatement of cost of property sold, resulting in an error in the computation of gross income, such overstatement does not constitute an *omission* from gross income of any amount properly includible therein within the meaning of Section 275(c) of the Internal Revenue Code of 1939.

Petitioner fully reported all of its gross receipts on its tax returns for its taxable years ended October 31, 1946 and October 31, 1947. However, petitioner, in good faith, but erroneously, overstated the cost of the property sold in said tax returns.[4] In subtracting the erroneously overstated cost of the property sold from the correctly stated gross receipts, the error in the *subtrahend* was carried forward, thereby reducing petitioner's reported gross profit on sales and gross income in an amount equal to the erroneous overstatement of the cost of the property sold.

Respondent's statutory notice of deficiency was mailed after the expiration of the general three year statute of limitations provided for by Section 275(a) of the Internal Revenue Code of 1939. The ultimate issue in the case is whether the extended five year

[4]The principal item of overstatement consisted of the cost of constructing a water supply system in the amount of $33,781.70. In ruling against petitioner on this item, the Tax Court recognized the legal issue involved and was compelled to distinguish the case of *Country Club Estates, Inc.* (1954), 22 T. C. 1283, 1293-1294. Thus, petitioner's original computation of cost reported on its tax returns had a reasonable basis, and *there is no suggestion of fraud, negligence or lack of good faith* in this case.

period of limitations contained in Section 275(c) of the Internal Revenue Code of 1939 is applicable. Section 275(c) reads as follows:

> "Sec. 275—Period of Limitation Upon Assessment and Collection.
>
> * * * * * * * *
>
> "(c) *Omission from Gross Income.*—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25% of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within five years after the return was filed."

Petitioner contends that it did not "omit(s) from gross income an amount properly includible therein" within the meaning of Section 275(c) by reason of the erroneous overstatement of the cost of the property sold. Petitioner asserts that the word "omits" in the statute means what it says; and a taxpayer "omits" an amount from gross income within the meaning of Section 275(c) *only when he leaves some item of receipt out of his computation of gross income.*

On the other hand, respondent contends "that where, as in the case at bar, a taxpayer overstates basis by more than 25% in reporting gains from the sale of property, the result is an understatement of gross income by more than 25%, and the requirements of 275(c) are met."[5] Thus respondent would have this

[5]Memorandum for the Respondent, page 4, in response to the petition for a writ of certiorari.

Court construe the statutory language "omits from gross income any amount properly includible therein" as if it read "understates the final figure in his gross income computation".

The issue in this case is therefore reduced to the narrow question of the proper statutory construction to be given to the statutory language "omits from gross income any amount properly includible therein". For the reasons hereinafter stated, petitioner asserts that the extended period of limitations can not be invoked by the Commissioner unless a taxpayer *leaves out* some item of receipt from his computation of gross income.

A. The Statutory Language.

The heading of Subsection (c) of Section 275 is entitled "*Omission From Gross Income.*"

The key word in the statute is the verb "omits". Congress could have chosen another verb such as "reduces", or "understates", both of which verbs have broader meaning. It did not choose these words, but selected "omits".

"Omit" has a definite and restricted meaning. *Webster's New International Dictionary*, 2d ed. (1939), defines "omit" as "to leave out or unmentioned; not to insert, include or name".

The Court of Appeals for the Sixth Circuit has similarly defined "omits" as meaning "to disregard, to fail, forbear, neglect to mention or fail to insert or include". *Ewald v. Commissioner* (C. A. 6th, 1944), 141 F. 2d 750, 752.

If the verb "omits" is given its normal and usual meaning, its use in the statute *is limited* to situations of the *leaving out* of specific items of receipt or gain that should properly be included in a taxpayer's computation of gross income.

As this Court stated in *DeGanay* v. *Lederer* (1919), 250 U. S. 376, 381, "Unless the contrary appears, statutory words are presumed to be used in their ordinary and usual sense, and with the meaning commonly attributable to them."

The clearest and strongest expression of congressional intent would have to be found in the legislative history before a holding could be justified that an overstated *subtrahend* is, or results in, an *omission*.

B. The Legislative History of Section 275(c).

The legislative history of the section shows that Congress carefully and deliberately selected the verb "omits", and intended for the usual meaning to be ascribed to it.

Section 275(c) was created by Congress as an exception to the long standing general three years period of limitation on assessment. The provision first appeared as Section 275(c) of the Revenue Act of 1934, c. 277, 48 Stat. 680. The bill, originating in the House, changed Section 276 of the Revenue Act of 1932, c. 209, 47 Stat. 169, relating to false or no returns, and carried no period of limitations. The intended coverage of the proposed provision was stated in a subcommittee report published as part of the House Hearings before the

Committee on Ways and Means, 73d Cong., 2d Sess., Revenue Revision of 1934, p. 139, as follows:

> "Section 276 provides for the assessment of tax without regard to the statute of limitations in case of a failure to file a return or in case of a false or fraudulent return with intent to evade tax.
>
> "Your subcommittee is of the opinion that the limitation period on assessment should also not apply to certain cases where the taxpayer has understated his gross income on his return by a large amount, even though fraud with intent to evade tax cannot be established. It is, therefore, recommended that the statute of limitations shall not apply where the taxpayer *has failed to disclose in his return* an amount of gross income in excess of 25 percent of the amount of the gross income stated in the return. The Government should not be penalized where a taxpayer is so negligent as to *leave out items* of such magnitude from his return." (Emphasis added.)

The subcommittee conceived of the proposed section as a parallel to the unlimited period for assessment with respect to taxpayers filing no returns, or fraudulent returns, and therefore recommended no period of limitation on assessment. Obviously, the subcommittee intended the proposed provision to apply only to situations tantamount to filing no return, or a fraudulent return, such as where a taxpayer "has failed to disclose in his return", or "leave(s) out" substantial items of income.

Curiously, the Treasury Department, represented by Roswell Magill, expressed opposition to the bill be-

cause it felt that three years was time enough for the Government "to find out about these things, and it is desirable at some time for a taxpayer to be able to know that his liability is closed in the absence of fraud" (Id. at p. 149).

At hearings held before the full Committee, the following colloquy ensued between the late Congressman Jere Cooper of Tennessee, speaking for the subcommittee, and Mr. Magill (Id p. 149):

> "Cooper: What we really had in mind was just this kind of a situation: Assume that a taxpayer left out, say, a million dollars; he just forgot it. We felt that whenever we found that he did that we ought to get the money on it, the tax on it.
>
> Magill: I will not argue against you on that score.
>
> Cooper: In other words, if a man is so negligent and so forgetful, or whatever the reason is, that he overlooks an item amounting to as much as 25 percent of his gross income, that we simply ought to have the opportunity of getting the tax on that amount of money.
>
> Magill: Yes; so far as the cases you have mentioned are concerned, we would certainly agree with you. Now, the fellow we were thinking of—and maybe we thought of him too much—i. the individual who had honestly tried to include all he thought he should have, but he did not."

The full Committee adopted the bill of its subcommittee. The report of the Committee, published in H. Rep. No. 704, 73d Cong., 2d Sess., p. 35 (1939-1 Cum. Bull. (Part 2) 554, 580), states in part as follows:

> ". . . It is not believed that taxpayers who are so negligent as to leave out of their returns items of such magnitude should be accorded the privilege of pleading the bar of the statute."

The Senate Finance Committee approved of the intended coverage and language of the bill, except that it felt that the absence of a cut-off period was not justified, stating in part in its report as follows:

> ". . . Your committee is in general accord with the policy expressed in this section of the House bill. However, it is believed that in the case of a taxpayer who makes an honest mistake, it would be unfair to keep the statute open indefinitely. For instance, a case might arise where a taxpayer failed to report a dividend because he was erroneously advised by the officers of the corporation that it was paid out of capital or he might report as income for one year an item of income which properly belonged in another year. Accordingly, your committee has provided for a 5-year statute in such cases." Senate Finance Committee Report, S. Rep. No. 588, 73d Cong., 2d Sess. pp. 43-44.

In the face of the clear statements of Congressional intent, respondent, on occasion, has stressed the infrequent use of the phrase "understates gross income" in the relevant Committee reports. Respondent ignores the fact that wherever this language appears, it is used in a general introductory statement. Immediately following each such reference is a specific restrictive statement or illustration of a "failure to disclose" income or "leaving out" items of receipt. See *Uptegrove*

Lumber Co. v. *Commissioner* (C. A. 3d, 1953), 204 F. 2d 570, 572.

It is impossible to review the legislative history of Section 275(c) without becoming convinced that it was designed only to give the Commissioner a period longer than three years to discover income in the case of taxpayers who had failed to fully report their receipts. All the discussion, all indicia of intent, point specifically and only to the taxpayer, who, to use the Committee's words, "failed to disclose", who was "so negligent as to *leave out* items of such magnitude", who "left out", who "was so negligent and so forgetful, or whatever the reason is, that he *overlooks* an item amounting to as much as 25%", who "failed to report". Nowhere in the legislative history can there be found indications that Congress intended for the extended statute to apply to situations such as in the case at bar.

C. Logic.

It was reasonable and logical for Congress to grant the Commissioner an additional two year period to assess deficiencies in respect of receipts omitted from a tax return. It was not that overstated costs, or inflated deductions were condoned, but merely that the latter did not present as substantial problems of discovery for the Internal Revenue Agents on audit. For benefit to be taken of an expenditure, it must be specifically claimed in the tax return, and the agent is *immediately put on notice by a mere examination of the return*, and should have ample opportunity to in-

vestigate. On the other hand, an omitted receipt requires a more complex process of detection. Congress gave the Commissioner two additional years to act in the last situation.

It is illogical to assume that Congress intended for an overstatement of cost of goods sold, resulting in a reduced gross income, to constitute an omission within the meaning of the statute. Expenditures forming a part of cost of goods sold are not different in nature from the deductible expenditures permitted by law.[6] In the latter case, it is clear that the Commissioner must challenge the claimed deductions within the normal three year limitation period. No reason appears why Congress would wish to allow a longer time to discover overstatements of the same type in the gross income section of the return. *Uptegrove Lumber Co.* v. *Commissioner, supra.* Consistency dictates otherwise.

Finally, it is general knowledge that a great number of all tax returns filed are returns for non-business individuals. In a majority of cases, gross receipts and gross income are synonymous. Obviously, the statute was intended for the sole purpose of extending the normal statutory period of limitations in cases where items of receipt were left out of a return.

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[6]Sec. 23 of the Internal Revenue Code of 1939 (26 U. S. C. 1946 ed., Sec. 23) provides that numerous business expenditures may be deducted (or subtracted) from "gross income" to arrive at "net" or "taxable" income upon which the tax is imposed. As previously mentioned, cost expenditures are also *subtrahend* items, and are subtracted (or deducted) from gross receipts to arrive at "Total income" or "gross income". Note 1, at page 4, *supra*.

D. The Cases in the Courts of Appeal.

The majority of the courts below have adopted the construction of the statute urged herein by the petitioner.

Frequently cited is *Uptegrove Lumber Co.* v. *Commissioner* (C. A. 3d, 1953), 204 F 2d 570 The facts therein can not possibly be distinguished materially from the facts in the instant case. In an opinion by Circuit Judge Hastie, the Court of Appeals for the Third Circuit meticulously reduced the issue to its essence, traced the legislative history of Section 275(c), pointed up the logical considerations, rejected the arguments of the Commissioner, and concluded that Section 275(c) could apply only where a taxpayer failed "to include some receipt or accrual in his computation of gross income".

Several months after its decision in *Uptegrove Lumber Co., supra,* the Court of Appeals for the Third Circuit was again called upon to interpret Section 275(c) in *Deakman-Wells Co.* v. *Commissioner* (C. A. 3d, 1954), 213 F. 2d 894. There, the taxpayer corporation kept its books of account on the accrual basis but filed its income tax returns on the cash basis. On the tax return, all gross receipts computed on the accrual basis were shown on a schedule attached to the return, and accounts receivable and accounts payable were added and subtracted therefrom in order to arrive at gross income computed on the cash basis.

The Court reaffirmed its reasoning and decision in the *Uptegrove* case, stating as follows, at page 897:

> ". . . We recently had occasion to consider the scope of that subsection in Uptegrove Lumber Co. v. Commissioner of Internal Revenue, 3, Cir., 1953, 204 F. 2d 570. *In that case we pointed out that the statute applies only where the taxpayer has failed to make a return of some taxable gain, where he has altogether omitted an item from the income reported, and not to a case such as this where he merely understates the final figure in his gross income computation, the item in question having been disclosed in the return but eliminated in the computation of the final figure.* We adhere to the views which we expressed in the Uptegrove case and conclude that the Tax Court erred in holding section 275(c) applicable." (Emphasis added.)

On March 4, 1955, the Court of Appeals for the Ninth Circuit held that the extended statute of limitations provided by Section 275(c) was inapplicable where a taxpayer made full disclosure of all receipts on his return. *Slaff* v. *Commissioner* (C. A. 9th, 1955), 220 F. 2d 65. In upholding the contentions of the taxpayer, the Court of Appeals for the Ninth Circuit stated that it was in full accord with the rulings of the Court of Appeals for the Third Circuit in *Uptegrove Lumber Co., supra,* and *Deakman-Wells Co., supra.*

The next pertinent decision by a Court of Appeals was handed down on February 29, 1956, by the Fifth Circuit in the case of *Davis* v. *Hightower* (C. A. 5th,

1956), 230 F. 2d 549. Therein the taxpayer treated profits from the sale of cotton as capital gains, and only 50% of the profits were included in the computation of gross income on the face of the return. In deciding that Section 275(c) was inapplicable, the Court adopted the interpretation thereof enunciated by the Court of Appeals for the Third Circuit in the *Uptegrove* and *Deakman-Wells'* cases, and approved by the Court of Appeals for the Ninth Circuit in the *Slaff* case.

In the latter part of 1956, the Court of Appeals for the Eighth Circuit expressly approved as "sound" and "logical" the aforesaid decisions of the Court of Appeals of the Third Circuit. *Goodenow* v. *Commissioner* (C. A. 8th, 1956), 238 F. 2d 20.[7]

Four Circuit Courts of Appeal, therefore, have uniformly held in varying factual situations that the verb "omits" as used in Section 275(c) means "leaves out" some item of receipt from the computation of gross income. Each court has *rejected* the plea that the statute be extended to read "If the taxpayer *understates the final figure* in his gross income computation". It is respectfully submitted that the opinions of the Courts of Appeal for the Third, Ninth, Fifth and Eighth Circuits, and of the Court of Claims, warrant careful consideration by this Court.

The decision of the court below in the instant case, and in *Reis* v. *Commissioner* (C. A. 6th, 1944), 142 F. 2d 900, is in direct conflict with the above cited deci-

[7] *Cf. Lazarus* v. *United States* (Ct. Cls., 1956), 142 F. Supp. 897.

sions In the appellate courts, the decisions of the Court of Appeals for the Sixth Circuit stand alone.[8]

The opinion of the court below in the instant case suggests misgivings. After referring to the above cited cases decided by the Courts of Appeal for the Third, Ninth, Eighth and Fifth Circuits, the court stated as follows (R. 42):

> "The reasoning of these cases is not without considerable persuasive force and if the question were here for the first time we might be disposed to follow them. However, the question has already been decided by the Court in *Reis* v. *Commissioner*, . . ."

The conflicting decisions of the Court of Appeals for the Sixth Circuit appear to be a judicial accident. In *Ewald* v. *Commissioner* (C. A. 6th), 141 F. 2d 750, where the taxpayer *left out* a substantial amount of trust income properly includible in his computation of gross income, the court correctly found an *omission* from gross income within the meaning of Section 275(c). Subsequently, in the *Reis* case, *supra*, which involved an overstatement of cost of goods sold, the court, apparently without careful analysis, erroneously found an omission, *citing the Ewald case as authority*. The mistake was compounded in the instant case.

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[8]The decisions of the Tax Court of the United States are in accord with the position taken by the Court of Appeals of the Sixth Circuit. However, after the appellate court decisions in *Uptegrove Lumber Co., supra, Deakman-Wells, supra*, and *Slaff* v. *Commissioner, supra*, four of the twelve Judges of the Tax Court adopted the principles and reasoning expressed therein. See *Goodenow* v. *Commissioner* (1955), 25 T. C. 1, 4 (dissenting).

The *Ewald* decision is correct. The decisions in *Reis* and in the instant case, where the facts were totally different, are erroneous. The statutory language, legislative history, logic and the weight of judicial authority incontrovertibly establish that Section 275(c) can not justifiably be extended to embrace mathematical understatements resulting solely from overstated *subtrahends*.

E. Section 6501(e)(1)(A) of the Internal Revenue Code of 1954.

The conflicting interpretations of Section 275(c) enunciated in the *Uptegrove Lumber Co.* case, *supra*, on the one hand, and the *Reis* case, *supra*, and numerous decisions of the Tax Court, on the other hand, were well known prior to the enactment of the Internal Revenue Code of 1954.

In 1954, Congress enacted Section 6501(e)(1)(A) of the 1954 Code[9] as the successor provision to Sec-

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[9] "(e) *Omission From Gross Income.*—Except as otherwise provided in subsection (c)—

(1) *Income Taxes.*—In the case of any tax imposed by subtitle A—

(A) *General Rule.*—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph—

(i) In the case of a trade or business, the term 'gross income' means the total of the amounts received or accured from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and

(Footnote continued on following page)

tion 275(c) of the 1939 Code. The same language "omits from gross income an amount properly includible therein" was re-enacted, and, by way of addendum, subsection (i) was inserted. Subsection (i) expressly spells out the construction of Section 275(c) contended for by petitioner.

Congress must have enacted the new language of the 1954 Code to clarify existing law. The Court of Appeals for the Fifth Circuit in *Davis v. Hightower, supra*, has so held, stating at page 554 as follows:

> "The two cases decided by the Court of Appeals for the Third Circuit recognize that either construction could be placed on this statute (Section 275(c)) and largely on the basis of the legislative history, it makes the test the question whether a specific item of income has been completely omitted from the return.[6] To this legislative history is now added the amendment contained in the 1954 Internal Revenue Code, under the terms of which it is now clear that the inclusion of the statement made by appellee in his return here would be sufficient to prevent application of the five year statute.[7] *In view of the confusion as to the meaning of the statute prior to the adoption of the 1954 Code, we think it plain that the new language was enacted to clarify the existing law.*" (Emphasis added.) (Footnotes 6 and 7 omitted.)

(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item."

CONCLUSION.

The statutory language of Section 275(c), its legislative history, logical reasoning, the weight of judicial authority in the courts below, and the enactment by Congress of Section 6501(e)(1)(A) of the Internal Revenue Code of 1954 establish:

(1) "Omits from gross income any amount properly includible therein", as used in Section 275(c) of the 1939 Code, means leaving out items of receipt in the computation of gross income;

(2) An overstatement of the cost of property sold, resulting in an error in the computation of gross income, does not constitute an omission from gross income of any amount properly includible therein, within the meaning of the statute.

For the foregoing reasons, it is respectfully submitted that the judgment of the Court of Appeals for the Sixth Circuit must be reversed.

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